IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE U.S. PHYSICIANS, INC.	:	**CIVIL ACTION**
	:	
	:	**NO. 00-4622**
	:	
	:	**(ADVERSARY NO. 00-138)**
	:	
	:	
DANIEL GRAUMAN, CHAPTER 7 TRUSTEE, U.S. PHYSICIANS, INC.	:	
	:	
v.	:	
	:	
DONALD B. SMITH, M.D.	:	

M E M O R A N D U M

WALDMAN, J. **July 12, 2001**

Presently before the court is defendant Smith's objections to the Report and Recommendation of the Bankruptcy Judge in this case involving the bankruptcy of U.S. Physicians, Incorporated (the "Debtor").

Defendant and Dr. William Fritz had owned and operated an entity called Bone and Joint Specialists ("B&J"). On January 28, 1997, B&J entered into an asset purchase agreement with the Debtor after which defendant and Dr. Fritz became employees of the Debtor. On June 16, 1998, defendant received a $100,000 check from the Debtor drawn on its account (the "Check"). The Trustee concluded that the Check was a short-term interest-free loan to defendant which the parties intended to be paid off as soon as defendant's refinancing of his house was completed.

Defendant's refinancing was completed on July 16, 1998. Defendant never remitted funds in repayment.

On October 30, 1998, the Debtor filed for bankruptcy protection under Chapter 11. On November 9, 1998, the Debtor's cases were converted into Chapter 7 cases. Daniel Grauman was elected the permanent Chapter 7 trustee on April 12, 1999. He instituted the instant adversary action on February 2, 2000 for turnover under 11 U.S.C. § 542.

The Trustee submitted substantial evidence at trial that the Check was a loan. This evidence included a tissue copy of the Check on which was written "Smith, Donald-Note," a Check Request form dated June 16, 1998 which records a $100,000 check issued to Donald Smith for a "short-term, interest free advance," the Debtor's ledger showing that the Check was cashed and the Debtor's accounts payable records. The Trustee produced contemporaneous hand-written notes of Mr. Edward Miersch, then-Chief Operating Officer of the Debtor, indicating that Mr. Miersch and defendant discussed a $100,000 loan. Mr. Miersch also testified that the Check was for a short-term interest free loan to be repaid upon completion of the refinancing of defendant's home.

It was established at trial that defendant and his wife filed a joint 1998 federal tax return which did not declare the $100,000 as income and that no taxes were deducted from or paid on the $100,000.

Mrs. Smith worked between forty and fifty hours a week for Debtor between May 1997 and October 1998. Defendant and his wife testified that the Check was payment for Mrs. Smith's services. Defendant, however, produced absolutely no documentation supporting this claim and offered no explanation of why compensation owed to his wife would be paid to him. Mrs. Smith herself testified that Thomas Keene, the Debtor's CEO, and Mr. Miersch had made clear to her that she would be compensated for her services only after the Debtor's Initial Public Offering ("IPO") which never occurred. Moreover, defendant's wife prepared a memorandum to Mr. Miersch sometime after November 9, 1998 tallying the hours that she worked for the Debtor (the "Compensation Memorandum"). In the Compensation Memorandum, Mrs. Smith stated that she was "submitting a request for payment for unpaid compensation for hours worked for [Debtor] from June 2, 1997 - October 31, 1998." Mrs. Smith stated she had worked a total of 2,163 hours and claimed compensation due in the amount of $54,075.00, barely half the amount of the Check.

The Bankruptcy Judge found the resolution of the Trustee's turnover claim to be non-core, and in accordance with Fed. R. Bankr. P. 9033 submitted Proposed Findings of Fact and Conclusions of Law. The Bankruptcy Judge concluded that the $100,000 was a loan and recommended that the Court award the Trustee $100,000 for the loan principal plus pre-judgment interest at six percent through the date of judgment. Defendant

has asserted various objections to the Report and Recommendation based on the Bankruptcy Court record. He has not submitted any new evidence.

The court conducts a de novo review, based on the record and any additional evidence, of any portion of the bankruptcy judge's findings of fact or conclusions of law to which specific written objection has been made. See Fed. R. Bankr. P. 9033. The court may accept, reject or modify proposed findings of fact or conclusions of law, receive further evidence or recommit the matter to the bankruptcy judge. Id. Jurisdictional decisions of bankruptcy courts also are subject to de novo review. See In re Midgard Corp., 204 B.R. 764, 770 (10th Cir. 1997).

Objection to Jurisdiction of Bankruptcy Court

Defendant objects to the exercise of jurisdiction by the Bankruptcy Court. He contends that the Bankruptcy Court should have abstained on either mandatory or permissive abstention grounds.

A threshold requirement for mandatory abstention is a timely motion. See 28 U.S.C. § 1334(c)(2); In re Warren, 125 B.R. 128, 131 (E.D. Pa. 1991). The Bankruptcy Court found that it was not required to abstain because defendant had not timely raised the issue. Defendant acknowledges that he first raised the issue in a post-trial brief. See Federation of Puerto Rican Orgs. v. Howe, 157 B.R. 206, 211 (E.D.N.Y. 1993) (failure to move

for abstention before trial constitutes waiver); In re Novak, 116 B.R. 626, 628 (N.D. Ill. 1990) (mandatory abstention not warranted when party failed timely to move for abstention).[1]

The Bankruptcy Court found that permissive abstention was unwarranted. In assessing whether abstention on permissive grounds is appropriate, a court considers the following non-inclusive factors: the effect on the efficient administration of the bankruptcy estate; the extent to which issues of state law predominate; the difficulty or unsettled nature of applicable state law; comity; the degree of relatedness or remoteness of the proceeding to the main bankruptcy case; the existence of a right to a jury trial; and, prejudice to the involuntarily removed defendants. See McCormick v. Kochar, 1999 WL 1051776, *2 (E.D. Pa. Nov. 19, 1999) (citations omitted). The Bankruptcy Court properly concluded that plaintiff's failure timely to file a motion to abstain coupled with the simplicity of applicable state law, the absence of any special state interest and the disruption to the administration of justice weighed strongly against abstention. Abstention after trial would unduly prolong the process of settling the case and the estate liquidation. See id.; Bancor/Morristown Ltd. P'ship v. Vector Whippany, 181

[1]There also is no showing or suggestion of a pending state court proceeding at the time, also a requirement for mandatory abstention. See In re Warren, 125 B.R. at 131. See also In re West Coast Video Enters., Inc., 145 B.R. 484, 486 (E.D. Pa. 1992) (mandatory abstention inappropriate as debtor had no pending state court action against defendant).

B.R. 781, 788 (D.N.J. 1995). Whether the Debtor had a rightful claim to $100,000 for payment of creditors was certainly not remote from the main bankruptcy case. Abstention would also unfairly benefit defendant by giving him another bite at the apple and unfairly prejudice the Trustee by requiring him to re-litigate this matter in another forum at further expense to the estate.

Objections to Mr. Miersch's Testimony

Defendant contends that the Bankruptcy Court erred in admitting Mr. Miersch's testimony. He states that the Trustee's counsel blocked defendant's attempts to acquire Mr. Miersch's address and the address of Mr. Miersch's counsel and that the Trustee did not inform defendant of his intention to call Mr. Miersch as a witness. The Trustee avers that he provided Mr. Miersch's address to defendant promptly upon receipt of the information. Moreover, as the Bankruptcy Court noted at trial, defendant had ample opportunity to file a motion to compel discovery when he learned that the address for Mr. Miersch's was not current as defendant was aware that Mr. Miersch was no longer at that address fourteen days prior to trial. While the Trustee did not provide the address of Mr. Miersch's counsel, he avers without contradiction that defendant never requested Mr. Miersch's counsel's address. The Trustee submitted a letter transmitted by telefax to defendant nearly a month before the trial in which the Trustee identified Mr. Miersch as a likely

witness. Defendant does not dispute that he received the letter.

The Trustee avers without contradiction that Mr. Miersch's journal notes were produced to defendant by the Trustee promptly upon their discovery fourteen days before trial was scheduled to begin. The Bankruptcy Court properly admitted Mr. Miersch's testimony and journal notes.

Objections to Proposed Findings of Fact

Defendant objects to findings in paragraphs three, four, five, six, seven, eight, nine, eleven, fourteen, fifteen, seventeen, nineteen, twenty and twenty-one of the Bankruptcy Court's Proposed Findings of Fact.

In objecting to each of paragraphs three, four, six, seven, eleven and seventeen of the Proposed Findings, defendant merely states that each paragraph is "clearly erroneous and not supported by any credible evidence." The substantial weight of the evidence shows that the Debtor gave defendant $100,000 as a short-term interest-free loan upon his request, and that the funds were not earned income by Mrs. Smith for her services. Defendant's objections to paragraphs three, four, six, seven, eleven and seventeen are overruled.

Defendant objects to paragraph five as "clearly erroneous and not supported by any credible evidence." He contends there was no evidence to support the finding that "[t]he top of the Check read 'Donald Smith note'" and that the Trustee and Mr. Miersch could not find any documentation of the loan.

Defendant is correct that the top of the Check itself did not read "Donald Smith note." The tissue copy of the Check, however, records the Check as "Smith, Donald - Note." The precise proposed finding should have been that the tissue copy of the Check, and not the actual computer generated draft, contained the notation "Smith, Donald - Note." The imprecise reference appears to have been inadvertent. In any event, this is completely inconsequential in assessing the weight of the evidence.

The Trustee and Mr. Miersch did find documentation of the loan, including the tissue copy of the Check, the Check Request form, Mr. Miersch's notes of his conversation with defendant and the Debtor's general ledger. Mrs. Smith's Compensation Memorandum and the Smiths' 1998 tax return also strongly suggest that the $100,000 conveyed to defendant was not earned income by Mrs. Smith.[2] Defendant's objection to paragraph

[2]Defendant's explanation of the failure to declare the $100,000 as income despite the Smiths' conviction that it was is dubious or, if true, would approximate an admission of an intent to file a false return. Defendant testified that the Smiths, although reporting earned and investment income totaling $810,278, were financially strapped and would have had to borrow money to pay taxes on the $100,000. So, upon being told that the Debtor may demand repayment and knowing taxpayers have three years to file an amended return, the Smiths decided to wait to declare this as income until resolving the matter with the Debtor. If the Smiths truly believed the $100,000 was earned income, they were obliged to so declare it whether or not they were then able to pay the taxes due. The general purpose of an amended return is to correct honest mistakes and account for subsequent occurrences, and not to defer the declaration of earned income or payment of taxes. Someone who truly believed the $100,000 was earned income would reasonably be expected to so declare it in a return for the year it was received, and to file an amended return only if and when it were definitively determined to be otherwise.

five is overruled except insofar as it will be deemed modified to reflect that it is the tissue copy of the Check which reads "Smith, Donald - Note".

Defendant objects to paragraph nine as "clearly erroneous and not supported by any credible evidence," arguing that he and Mrs. Smith testified that they had not requested or received a loan. Paragraph nine does not discuss the testimony of defendant or his wife at all, but deals only with Mr. Miersch's notes. The Bankruptcy Court correctly found that Mr. Miersch's notes indicate on their face that defendant responded to Mr. Miersch's question about the loan by saying that the "house loan [was] coming through maybe next week" and that defendant told Mr. Miersch that the refinancing was delayed. This objection is overruled.

Defendant objects to paragraph fourteen, arguing that the testimony of George L. Miller, CPA regarding defendants' 1998 tax return was redundant and beyond the scope of plaintiff's discovery responses. He also argues that the Bankruptcy Court incorrectly allowed Mr. Miller to testify as an expert and provide an expert opinion regarding defendants' tax return. The objection is overruled.

The court cannot determine that the testimony was beyond the scope of plaintiff's discovery responses as they are not of record. See, e.g., Freiberg v. Sentry Ins. Co., 1995 WL 165896, * 8 (E.D. Pa. Oct. 25, 1990) (without specifying nature

of prejudice and supporting evidence, motion for new trial on ground that testimony beyond scope of discovery responses must be denied). Mr. Miller's testimony was not redundant as the Trustee did not present other testimony about defendants' tax return. Mr. Miller's testimony concerning what defendant and his wife reported on their tax return also was not expert testimony, but rather lay opinion testimony. Federal Rule of Evidence 701 "contemplates admission of lay opinions rationally based on personal knowledge so as to be helpful to the trier of fact." See Asplundh Mfg. v. Benton Harbor Eng'g, 57 F.3d 1190, 1193 (3d Cir. 1995). Mr. Miller's testimony that the Smiths had not reported the $100,000 as income on their 1998 tax return was based on his review of the forms, was rationally based on his personal knowledge and was helpful to the Bankruptcy Court.

Mr. Miller's testimony about which of the Debtor's accounts employee compensation would be subtracted from was also lay opinion and properly admitted. See Teen-Ed v. Kimball Int'l, Inc., 620 F.2d 399, 403-404 (3d Cir. 1980) (accountant familiar with books could give lay opinion about how lost profits would be calculated). While Mr. Miller's testimony concerning the requirement that one report all income on his or her tax return was arguably expert testimony, defendant had stipulated at trial to Mr. Miller's qualification as a tax accounting expert. Moreover, the requirement to report all income and pay taxes upon it at rates set forth in published schedules in booklets mailed

each year to taxpayers is common knowledge and something which may be judicially noticed.

Defendant objects to paragraph fifteen as "clearly erroneous and not supported by any credible evidence." The trial transcript reflects that both defendant and Mrs. Smith testified that she worked forty to fifty hours a week from May 1997 to October 1998 and that she was to be compensated after the contemplated IPO. This objection is utterly without merit and is overruled.

Defendant objects to paragraph nineteen as "clearly erroneous and not supported by any credible evidence," and as irrelevant. Paragraph nineteen discusses Mrs. Smith's testimony regarding her Compensation Memorandum and the fact that taxes were not deducted and that Mrs. Smith never requested a W-2 statement. This finding is clearly supported by Mrs. Smith's testimony and the tissue copy of the Check. The finding is highly relevant on the key issue of whether the Check was a loan to defendant or payment for services rendered by Mrs. Smith. This objection is overruled.

Defendant objects to paragraph twenty on several grounds. In addition to claiming the finding was "clearly erroneous and not supported by any credible evidence," defendant complains that the Bankruptcy Court did not discuss Mrs. Smith's testimony that she had not filed a proof of claim because she considered the $100,000 as payment for her services and she was

listed as the Debtor's employee. Defendant further objects that the Bankruptcy Court does not address the fact that Mrs. Smith was listed as the Debtor's employee, was receiving medical benefits and had applied for participation in the Debtor's 401K program. Defendant finally objects that the Bankruptcy Court did not reconcile Mrs. Smith's testimony regarding her employee status with the fact that the Debtor did not pay her. This objection is overruled.

There was no reason for the Bankruptcy Court to make underlying factual findings about Mrs. Smith's employment relationship as it was undisputed by the parties that she was an employee of the Debtor. Moreover, paragraph thirteen does state that Mr. Miersch acknowledged that Mrs. Smith provided services to the Debtor and the second sentence of paragraph nineteen does reference Mrs. Smith's testimony concerning her decision not to file a proof of claim. The Bankruptcy Court did reconcile Mrs. Smith's employee status with the Debtor's failure to compensate her. Paragraph eleven states that defendant and Mr. Miersch had agreed that Mrs. Smith would be compensated after the contemplated IPO which never occurred.

Defendant objects to paragraph twenty-one as "clearly erroneous and not supported by any credible evidence." He also argues that the Check does not support Mr. Miersch's version that it was a loan; that the only documents showing that the Check was a loan were self-serving internal memoranda; the Trustee's

documents do not account for the uncompensated services by Mrs. Smith; and, that the Smiths' testimony was consistent with their contention that the $100,000 was compensation to Mrs. Smith for services rendered. Defendant also contends that the Bankruptcy Court's finding that Mr. Miersch was a financially disinterested party was erroneous because he was a creditor of the Debtor.

Paragraph twenty-one is amply supported by the evidence including the tissue copy of the Check, the ledger showing that the Check was cashed, the Check Request form, the Debtor's general ledger, the Smiths' 1998 tax return on which the payment was not declared as income, Mrs. Smith's Compensation Memorandum, Mr. Miersch's notes and testimony, and the testimony of Mrs. Smith herself that she understood she would be compensated for her services only after the IPO. Key documents relied on by the Bankruptcy Court were not self-serving internal memoranda. The documents included contemporaneous business records, defendants' own tax return and Mrs. Smith's Compensation Memorandum.

The Bankruptcy Court's characterization of Mr. Miersch as financially disinterested was essentially, if not literally, correct. Mr. Miersch had an unsecured claim for unpaid wages and expenses. There is, however, no evidence that Mr. Miersch had any prospect of receiving any appreciable amount from the recapture of $100,000. His claim was for $10,755.91. The unsecured claims against the Debtor totaled $17,888,184. Moreover, except for his discussion regarding the understanding

that Mrs. Smith would be compensated only after the IPO which she herself admitted, Mr. Miersch's testimony tracked his contemporaneous journal notes prepared at a time when he had no potential bias or self-interest. Also, in crediting Mr. Miersch's testimony, the Bankruptcy Court stressed that it was logical and totally consistent with other evidence. This it was.

Indeed, on the record presented, one could not reasonably conclude that the $100,000 check payable to defendant was compensation to his wife for $54,000 worth of services claimed by her which was to have been paid after a contemplated IPT that never occurred and which she never declared as income. Defendant's objections to paragraph twenty-one are overruled.

Objections to Proposed Conclusions of Law

For the most part, these are not actually objections to any statement of applicable law but rather a rehash of defendant's factual objections. Defendant objects to paragraph one of the proposed conclusions as "clearly erroneous and not supported by any credible evidence." As already discussed, the documentary and testimonial evidence presented convincingly shows that the $100,000 payment was a loan to defendant and not earned income to his wife.

Defendant objects to paragraph two as "clearly erroneous and not supported by any credible evidence." Paragraph two addresses defendant's contention that he is entitled to a setoff for Mrs. Smith's services to the Debtor under 11 U.S.C. §§ 502 and 553.

The Bankruptcy Court properly concluded that defendant had not raised the issue of setoff until his post-trial submission and had thus waived such a defense. Defendant suggests that he raised the defense in paragraphs 31-33 in his answer to the adversary complaint. In the answer, however, defendant states only that "plaintiff's payments to defendant were a contemporaneous or substantially contemporaneous exchange for value for services provided by plaintiff to defendant";[3] the payments were "made in the ordinary course of business" and according to the usual industry course of dealings; and, if the payments are deemed an avoidable preference, defendant should have a claim under § 502 in the amount of any preference. It clearly appears that defendant only raised the defense of setoff with respect to funds owed to him for his services and not to his wife. Defendant in any event does not explain how he could legally offset sums owed to another.

It also appears that defendant raised a defense to a § 547 preference action, while the instant action is a turnover action under § 542. Defendant did not raise the defense of setoff for funds allegedly owed to his wife in his answer or at any time before or during trial. Even assuming such a defense could have been asserted, it was waived.

[3]The court assumes that defendant meant to assert that the services were provided by defendant to plaintiff as this sentence otherwise would be nonsensical.

Insofar as defendant attempted to assert a separate claim for compensation allegedly owed to Mrs. Smith by the Debtor in his post-trial submission, it was not his claim to assert. Even assuming it were, it would have been a compulsory counterclaim as it arose from the same transaction and thus would have had to be pled as a counterclaim. See Fed. R. Civ. P. 13; Fed. R. Bky. P. 7013. It was not and thus any such claim was waived. See Fed. R. Civ. P. 8(c); Moore's Fed. Practice 3d § 8.07[5]. The Bankruptcy Court also correctly noted that since Mrs. Smith was not a party in the bankruptcy proceeding, she could not raise a counterclaim in it. See Stahl v. Ohio River Co., 424 F.2d 52, 55 (3d Cir. 1970) ("counterclaims are litigated between opposing parties to the principal action"); Zion v. Sentry Safety Control Corp., 258 F.2d 31, 33 (3d Cir. 1958) (counterclaim "must be one which pleader himself has"). The Bankruptcy Court properly concluded that because Mrs. Smith had failed to file a Proof of Claim by the bar date, she could not raise this claim. See In re Lloyd Securities, Inc., 156 B.R. 750, 755 (Bankr. E.D. Pa. 1993).

Defendant objects to paragraph three as "clearly erroneous and not supported by any credible evidence." He argues that there was no evidence that the loan was to be paid back at a specific time or that the loan existed except self-serving internal memos. Mr. Miersch's testimony that the loan was to be

repaid after defendant's refinancing was completed and his notes of his conversation with defendant regarding the pendency of the refinancing show that defendant was aware of the term of repayment. Moreover, the Check Request form noting that the payment was a short-term loan supports the Trustee's claim that the parties intended the Check to be a loan to be repaid upon completion of the refinancing. As already discussed, there was substantial additional evidence that the loan existed.

Defendant's objections to the Bankruptcy Court's Proposed Conclusions of Law are without merit and are rejected. Except for the inconsequential inadvertent reference to the tissue copy of the Check as the Check, the proposed findings of fact are entirely sound and well supported.

It clearly and convincingly appears on the record presented that the Trustee has sustained his claim against defendant. Accordingly, the Report and Recommendation will be adopted and judgment will be entered for the Trustee. An appropriate order will be entered.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE U.S. PHYSICIANS, INC.	:	**CIVIL ACTION**
	:	
	:	**NO. 00-4622**
	:	
	:	**(ADVERSARY NO. 00-138)**
	:	
	:	
DANIEL GRAUMAN, CHAPTER 7 TRUSTEE, U.S. PHYSICIANS, INC.	:	
	:	
v.	:	
	:	
DONALD B. SMITH, M.D.	:	

O R D E R

AND NOW, this day of July, 2001, upon consideration of the Report and Recommendation of the Bankruptcy Court, defendant's objections thereto and the record herein, consistent with the accompanying memorandum, **IT IS HEREBY ORDERED** that the Report and Recommendation is approved and adopted and accordingly, **JUDGMENT is ENTERED** in this action for plaintiff Daniel Grauman as Trustee and against defendant Donald B. Smith in the amount of $100,000 plus interest at 6% from July 16, 1998 to date.

BY THE COURT:

_____
JAY C. WALDMAN, J.